

**TITLE 10 INVESTMENT
CHAPTER 5 INSURANCE COMMISSIONER
SUBCHAPTER 3 INSURERS
ARTICLE 3 ANNUAL STATEMENTS**

§ 2303 REINSURANCE ACCOUNTING, AGREEMENTS AND OVERSIGHT

Sections 2303 through 2303.26 of this article set forth the principal requirements of substance and procedure in accounting for reinsurance on insurer financial statements, the general requirements applicable to reinsurance agreements, and related sanctions and oversight. The sections are applicable to all insurers licensed in California, and may be referred to as the Reinsurance Accounting Regulations.

Note: Authority Cited: Sections 717, 720, 739.9, 922.8, 923, 1215.8, 1781.12, and 12921, Insurance Code; CalFarm Insurance Company v. Deukmejian, 48 Cal. 3d 805(1989); 20th Century Insurance Company v. Garamendi, 8 Cal. 4th 216 (1994). Reference: Sections 700, 701, 704, 717, 730, 733, 736, 739.10, 903, 903.5, 922.1, 922.2, 922.3, 922.4, 922.5, 922.6, 922.7, 922.8, 922.9, 923, 924, 925, 925.2, 1011.5, 1215.5(b)(3), 1215.5(f)(5), 1781.10, 1781.11 and 12921, Insurance Code.

§ 2303.1 PURPOSE AND AUTHORITY

Sections 2303 through 2303.26 of this article are promulgated as a necessary part of and as instructions to insurers for the proper and uniform preparation of the financial statements required by the California Insurance Code. The requirements are intended to elicit from insurers a true exhibit of their financial condition and to safeguard the solvency of licensees. The sections give notice as to the manner in which the Commissioner will exercise the discretion given to him by Code Sections 701, 704, 717(d), 733(f), 922.2 through 922.8, 923, 925, 925.2, 1011.5, 1215.5(b)(3), 1215.5(f)(5), 1781.10, and Section 12921 of the Code as respects accounting for reinsurance in insurer financial statements, acceptable reinsurance arrangements, and regulatory oversight. All statutory references are to the California Insurance Code unless otherwise stated.

It is impossible to foresee every contingency and provide a regulation in anticipation thereof. Therefore, the duties and discretion of the Insurance Commissioner conferred on him by statute to ensure proper accounting for reinsurance and oversight of reinsurance arrangements cannot be and are not exhausted by these regulations.

§ 2303.2 DEFINITIONS

As used in this article:

- (a) "Department" means the Department of Insurance of this state.
- (b) "Commissioner" means the Insurance Commissioner of this state.
- (c) "NAIC" means the National Association of Insurance Commissioners.
- (d) "NAIC Accounting Guidance" means the NAIC Accounting Practices and Procedures Manual and the NAIC annual statement blanks and instructions as made applicable to licensed insurers pursuant to Code Section 923.

- (e) "Insurer" includes "reinsurer" unless otherwise apparent from the context.
- (f) "Licensed insurer" means an insurer that has been issued a Certificate of Authority permitting it to transact insurance business in this state.
- (g) "Domestic insurer" means a licensed insurer incorporated and domiciled in this state.
- (h) "Foreign insurer" means a licensed insurer domiciled in another state.
- (i) "Foreign insurer with a significant volume of California business" includes any insurer whose volume of business is sufficient to be deemed a "commercially domiciled insurer" in this state pursuant to the provisions of Code Section 1215.13(a), or any insurer whose gross written premium in California is greater than its written premium in any other state as reported on its most recent annual statement.
- (j) "Ceding insurer" means the insurer that transfers risk to another insurer under a reinsurance agreement.
- (k) "Assuming insurer" or "reinsurer" means the insurer to which risk is transferred under a reinsurance agreement.
- (l) "Reinsurance intermediary" means a reinsurance intermediary-broker or a reinsurance intermediary manager, as defined in Code Section 1781.2.
- (m) "Accredited reinsurer" means an insurer that has been accredited pursuant to Code Section 922.4(b) and Section 2303.4 of this article.
- (n) "Approved trust" means the multiple beneficiary trust established by an insurer or group of insurers to secure obligations under reinsurance agreements, that has been approved pursuant to the provisions of Code Section 922.4(c) and Section 2303.5 of this article.
- (o) "Unauthorized reinsurer" means a reinsurer that is not licensed nor accredited in this state, and without an approved (multiple beneficiary) trust.
- (p) "Reinsurance contract" or "reinsurance agreement" means a contract by which an insurer transfers to another insurer all or part of its risk on business it has directly written or assumed.
- (q) "Financial statements" mean the statements and reports of an insurer filed with the Commissioner for the purpose of exhibiting the insurer's financial condition and affairs.
- (r) "RBC Report" means the Risk Based Capital report required of domestic insurers by Code Section 739.2, and of foreign insurers by their state of domicile.
- (s) "Examine" or "examination" as used in this article and in Code Section 730 includes an examination or review of any nature, scope or frequency by the Department of a licensed insurer, regardless of the location of the review or examination.

(t) "Regulatory oversight" means the exercise of any or all powers granted a regulator to monitor or control the operations of an insurer, where the insurer is, or is reasonably expected to be, in a hazardous financial condition; oversight may be formal or informal.

(u) "Verified" as used in this article and in Code Section 903 means an affirmation, made under penalty of perjury of the laws of this state, that specified facts are true and correct; verification may be made upon information and belief, unless personal knowledge of the facts stated is required.

§ 2303.3 CREDIT FOR REINSURANCE CEDED TO ADMITTED INSURER

Credit on financial statements shall be allowed for reinsurance ceded to an assuming insurer that was licensed in this state as of the date on which statutory financial statement credit for reinsurance is claimed, unless (1) the assuming insurer is the subject of a regulatory order or regulatory oversight on the grounds of financial hazard by any state in which it is licensed, whether such order or oversight is formal, informal, voluntary or confidential, (2) the cession is not in compliance with the applicable provisions of Sections 2303.11 through 2303.13 of this article, or (3) the assuming insurer was not licensed in this state for the lines or classes of business assumed.

§ 2303.4 CREDIT FOR REINSURANCE CEDED TO ACCREDITED REINSURER

(a) Credit on financial statements shall be allowed for reinsurance ceded to an assuming insurer that is accredited as a reinsurer in this state as of the date on which statutory financial statement credit for reinsurance is claimed, unless (1) the assuming insurer is the subject of a regulatory order or regulatory oversight on the grounds of financial hazard, by any state in which it is licensed, whether such order or oversight is formal, informal, voluntary, involuntary or confidential, (2) the cession is not in compliance with the applicable provisions of Sections 2303.11 through 2303.13 of this article, or (3) the assuming insurer was not licensed in its state of domicile for the lines or classes of business assumed.

(b) A reinsurer seeking accreditation shall file with the Commissioner:

1. A properly executed Certificate of Assuming Insurer Form AR-1, published in Section 2303.26(a) of this article, wherein the reinsurer:
 - A. Submits to the authority of the Commissioner to examine its books and records, and agrees to bear the expense of any such examination; and
 - B. Affirms it has attached to the Certificate a current list of its cedants domiciled in California, and undertakes to submit additions to or deletions from the list to the Commissioner at least once per calendar quarter.
2. A Designation of Agent for Service of Process and Consent to Jurisdiction Form AR-2, published in Section 2303.26(b) of this article, or an alternate form meeting the requirements of Section 2303.22 and approved by the Commissioner, wherein the reinsurer:
 - A. Appoints a licensed California attorney who is a resident of California as its agent for service of process upon whom may be served any notice,

summons or process in any action, suit, or proceeding instituted by or on behalf of the ceding insurer; and

- B. Submits to the jurisdiction of any court of competent jurisdiction in California for the adjudication of any issues arising from the underlying transaction.
- 3. A certified copy of a certificate of authority or other acceptable evidence of a license to transact insurance in at least one state;
- 4. A statement, signed and verified by an officer of the reinsurer, disclosing whether the reinsurer, or any affiliated person with an interest of 10% or more in the reinsurer, is currently known to be the subject of any order or proceeding initiated by a regulator in any jurisdiction, whether formal, informal, voluntary or confidential, regarding (1) conservation, liquidation or receivership, (2) revocation, suspension or regulatory oversight of a license or accreditation, or (3) restricting or precluding the transaction of insurance. The statement shall affirm that no actions, proceedings or orders subject to disclosure by this paragraph are outstanding, except as disclosed in the statement. The reinsurer shall attach to the statement copies of orders and documents initiating proceedings for matters disclosed in the statement. The statement shall be in a form acceptable to the Commissioner.
- 5. A copy of the reinsurer's:
 - A. Annual financial statements and all quarterly financial statements filed since the most recent annual statement, if any. The annual statements, including any amendments and NAIC required attachments, shall be signed and verified. Verification shall be made by oath of the reinsurer's principal executive officer or manager residing within the United States;
 - B. Most recent examination report, with an "as of" date of not more than 5 years prior to its submission;
 - C. Most recent independent audit report and report of internal controls, with an "as of" date of not more than 15 months prior to its submission;
 - D. Most recent 8-K, 10-K and 10-Q forms, if any, filed with the SEC by the applicant or any controlling person;
 - E. Certificate of good standing from its state of domicile;
 - F. Most recent holding company registration statement and any supplements thereto filed with its state of domicile,
 - G. Most recent RBC report, and
 - H. News releases issued by or on behalf of the reinsurer within the year prior to submission;
- 6. A current list of California domestic insurers from which business has been assumed; and

7. Additional information or documentation as requested by the Commissioner.
- (c) To establish continuing eligibility as an accredited reinsurer, the reinsurer shall:
1. File its quarterly and annual financial statements and its RBC report at the same time those documents are filed with its state of domicile;
 2. File an updated list of California domestic insurer cedants quarterly;
 3. File copies of news releases when issued; and
 4. File, on or before August 15 of each year, the documents required by subdivision (b) of this section, except that it is not necessary to file duplicates of financial documents already submitted.
- (d) The actual costs and expenses incurred by the Department to review a reinsurer's application for accreditation and subsequent filings shall be charged to and collected from the requesting reinsurer. The application and filings shall be submitted in the manner set forth in Section 2303.23 of this article.

§ 2303.5 CREDIT FOR REINSURANCE SECURED BY AN APPROVED TRUST

- (a) Credit on financial statements shall be allowed for reinsurance ceded to an assuming insurer which, as of any date on which statutory financial statement credit for reinsurance is claimed and thereafter for so long as credit for reinsurance is claimed, maintains a trust fund approved by the Commissioner in an amount prescribed in Section 922.4(c) of the Code in a qualified United States financial institution as security for the payment of the valid claims of its U.S. domiciled ceding insurers, their assigns and successors in interest, unless the cession is not in compliance with the applicable provisions of Sections 2303.11 through 2303.13 of this article.
- (b) In the determination of whether the trust is sufficient to cover the assuming insurer's liabilities, the term "liabilities" shall mean the assuming insurer's gross liabilities attributable to reinsurance ceded by United States domiciled insurers liabilities as of the end each calendar quarter that are not otherwise secured by acceptable means, and shall include:
1. For business ceded by insurers authorized to write either accident and health, or property and casualty insurance, or both:
 - A. Losses and allocated loss expenses paid by the ceding insurer recoverable from the assuming insurer;
 - B. Reserves for losses reported and outstanding;
 - C. Reserves for losses incurred but not reported;
 - D. Reserves for allocated loss expenses; and
 - E. Unearned premiums.

2. For business ceded by insurers authorized to write life, health and annuity insurance:
 - A. Aggregate reserves for life policies and contracts net of policy loans and net due and deferred premiums;
 - B. Aggregate reserves for accident and health policies;
 - C. Deposit funds and other liabilities without life or disability contingencies; and
 - D. Liabilities for policy and contract claims.

(c) Assets equal to liabilities shall be deposited in the trust no later than 45 days after the end of each calendar quarter unless the Commissioner determines that, for good cause shown, a reasonable extension of time to fund the deposit should be granted. The assets shall be valued according to their fair market value and shall consist only of cash in United States dollars, certificates of deposit issued by a United States financial institution as defined in Section 922.7(a) of the Code, letters of credit which meet the criteria specified in Section 2303.8 (c) of this article, or investments of the type specified in this subdivision, however, investments in or issued by an entity controlling, controlled by or under common control with either the grantor or beneficiary of the trust shall not exceed five percent (5 %) of total investments.

(d) No more than twenty percent (20%) of the total of the investments in the trust may be the foreign investments authorized under subparagraph (d)(1)(E), paragraph (d)(3), subparagraph (d)(6)(B) or paragraph (d)(7) of this section, and no more than ten percent (10%) of the total of the investments in the trust may be securities denominated in foreign currencies. For purposes of applying the preceding sentence, a depository receipt denominated in United States dollars and representing rights conferred by a foreign security shall be classified as a foreign investment denominated in a foreign currency.

(e) The assets of an approved trust shall be invested only as follows:

1. Government obligations that are not in default as to principal or interest, that are valid and legally authorized and that are issued, assumed or guaranteed by:
 - A. The United States or by any agency or instrumentality of the United States;
 - B. Any state of the United States;
 - C. A territory, possession or other governmental unit of the United States;
 - D. An agency or instrumentality of a government unit referred to in subparagraphs (B) and (C) of this paragraph, if the obligations shall be by law (statutory or otherwise) payable, as to both principal and interest, from taxes levied or by law required to be levied or from adequate special revenues pledged or otherwise appropriated or by law required to be provided for the purpose of making these payments, but shall not be obligations eligible for investment under this paragraph if payable solely

out of special assessments on properties benefited by local improvements; or

- E. The government of any other country that is a member of the Organization for Economic Cooperation and Development and whose government obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC.
2. Obligations that are issued in the United States, or that are dollar-denominated and issued in a non-U.S. market, by a solvent United States institution (other than an insurance company) or that are assumed or guaranteed by a solvent United States institution (other than an insurance company) and that are not in default as to principal or interest if the obligations:
 - A. Are rated A or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC, or if not so rated, are similar in structure and other material respects to other obligations of the same institution that are so rated; or
 - B. Are insured by at least one authorized insurer (other than the investing insurer or parent, subsidiary or affiliate of the investing insurer) licensed to insure obligations in this state and, after considering the insurance, are rated AAA (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC; or
 - C. Have been designated as Class One or Class Two by the Securities Valuation Office of the NAIC.
 3. Obligations issued, assumed or guaranteed by a solvent non-United States institution chartered in a country that is a member of the Organization for Economic Cooperation and Development or obligations of U.S. corporations issued in a non-U.S. currency, provided that in either case the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC.
 4. An investment made pursuant to the provisions of paragraphs (d)(1), (d)(2) or (d)(3) of this section shall be subject to the following additional limitations:
 - A. An investment in or loan upon the obligations of any one institution, other than an institution that issues mortgage-related securities, shall not exceed five percent (5 %) of the assets of the trust;
 - B. An investment in any one mortgage-related security shall not exceed five percent (5 %) of the assets of the trust;
 - C. The aggregate total investment in mortgage-related securities shall not exceed twenty-five percent (25 %) of the assets of the trust; and
 - D. Preferred or guaranteed shares issued or guaranteed by a solvent United States institution are permissible investments if all of the institution's obligations are eligible as investments under subparagraphs (d)(2)(A) and

(d)(2)(C) of this section, but shall not exceed two percent (2%) of the assets of the trust.

5. As used in this subdivision:

- A. "Mortgage-related security" means an obligation that is rated AA or higher (or the equivalent thereto) by a securities rating agency recognized by the Securities Valuation Office of the NAIC and:
- i. represents ownership of one or more promissory notes or certificates of interest or participation in such notes (including any rights designed to assure servicing of, or the receipt or timeliness of receipt by the holders of such notes, certificates, or participation of amounts payable under, such notes, certificates or participation), which notes:
 - a. are directly secured by a first lien on a single parcel of real estate, including stock allocated to a dwelling unit in a residential cooperative housing corporation, upon which is located a dwelling or mixed residential and commercial structure, or on a residential manufactured home as defined in 42 U.S.C.A. Section 5402(6), whether the manufactured home is considered real or personal property under the laws of the state in which it is located; and
 - b. were originated by a savings and loan association, savings bank, commercial bank, credit union, insurance company, or similar institution that is supervised and examined by a federal or state housing authority, or by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. Sections 1709 and 1715b, or, where such notes involve a lien on the manufactured home, by any such institution or by any financial institution approved for insurance by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. section 1703; or
 - ii. is secured by one or more promissory notes or certificates of deposit or participation in such notes (with or without recourse to the insurer thereof) and, by its terms, provides for payments of principal in relation to payments or reasonable projections of payments, or notes meeting the requirements of subitems (d)(5)(A)(i)(a) and (d)(5)(A)(i)(b) of this section.
- B. "Promissory note", when used in connection with a manufactured home, shall also include a loan, advance or credit sale as evidenced by a retail installment sales contract or other instrument.

6. Investments in common shares or partnership interests of a solvent United States institution are permissible if:

- A. Its obligations and preferred shares, if any, are eligible as investments under this subdivision; and
 - B. The equity interests of the institution (except an insurance company) are registered on a national securities exchange, as provided in the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78kk or otherwise registered pursuant to that Act, and, if otherwise registered, price quotations for them are furnished through a nationwide automated quotations system approved by the National Association of Securities Dealers, Inc. A trust shall not invest in equity interests under this subparagraph an amount exceeding one percent (1 %) of the assets of the trust even though the equity interests are so registered and are not issued by an insurance company.
- 7. Investments in common shares of a solvent institution organized under the laws of a country that is a member of the Organization for Economic Cooperation and Development are permissible if:
 - A. All its obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC; and
 - B. The equity interests of the institution are registered on a securities exchange regulated by the government of a country that is a member of the Organization for Economic Cooperation and Development.
- 8. An investment in or loan upon any one institution's outstanding equity interests shall not exceed one percent (1 %) of the assets of the trust.
- 9. Obligations issued, assumed or guaranteed by a multinational development bank, provided the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC.
- 10. Securities of an investment company registered pursuant to the Investment Company Act of 1940, 15 U.S.C. § 802, are permissible investments if the investment company invests at least ninety percent (90%) of its assets in the types of securities that qualify as an investment under paragraphs (d)(1), (d)(2) or (d)(3) of this section; or that invests in securities that are determined by the Commissioner to be substantively similar to permitted securities; or invests at least ninety percent (90%) of its assets in the types of equity interests that qualify as an investment under paragraph (d)(6) of this section. Investments made by a trust under this subparagraph shall not exceed ten percent (10%) of the assets in the trust and the aggregate amount of investment in qualifying investment companies shall not exceed twenty-five percent (25 %) of the assets in the trust. Investments in an investment company qualifying under this paragraph shall not exceed five percent (5 %) of the assets in the trust.
- 9. The cost of an investment in equity interests made pursuant to subparagraphs (6), (7), (8) or (10), when added to the aggregate cost of other investments in equity interests then held pursuant to those subparagraphs, shall not exceed ten percent (10%) of the assets in the trust.

- (f) In order for a letter of credit to qualify as an asset of an approved trust:
1. The trust agreement shall provide that the trustee shall have the right and the responsibility to immediately draw down the full amount of the letter of credit and hold the proceeds in the trust if the letter of credit will expire without replacement or renewal.
 2. The trust agreement shall provide that the trustee shall be liable for all loss resulting from its negligence, willful misconduct or lack of good faith, including the loss of cash up to the full available amount of the letter of credit and including any expenses incurred by the ceding company from its inability to timely access the available funds. The trust agreement shall provide that failure of the trustee to draw against the letter of credit in circumstances where the draw would be required shall be deemed as negligence and/or willful misconduct.
 3. The letter of credit shall be issued by a qualified United States financial institution meeting the requirements of Code Section 922.7 and shall be in a form acceptable to the Commissioner.
- (g) Security provided to a ceding insurer by an assuming insurer pursuant to Section 2303.7, 2303.8 or 2303.9 of this article shall be applied, until exhausted, to the payment of liabilities of the assuming insurer to the ceding insurer holding the specific security as a condition precedent for presentation of a claim by the ceding insurer for payment by a trustee of a trust established by the assuming insurer pursuant to this section. The condition precedent shall be deemed satisfied if security held under Section 2303.9 of this article has been exhausted, and a demand for payment of the security established by the assuming insurer under Section 2303.7 or 2303.8 of this article has not been met within sixty (60) days of the demand.
- (h) Assuming insurers or groups seeking approval of a trust under Code Section 922.4(c) shall file with the Commissioner:
1. A certified copy of the trust document, duplicates of all documents submitted to the state which has principal regulatory oversight of the trust, including its audit report, actuarial opinion, CPA report, and any other documents requested.
 2. A properly executed Certificate of Assuming Insurer Form AR-1, published in Section 2303.26(a) of this article, wherein the reinsurer:
 - A. Submits to the authority of the Commissioner to examine its books and records, and agrees to bear the expense of any such examination; and
 - B. Affirms it has attached to the Certificate a current list of its cedants domiciled in California, and undertakes to submit additions to or deletions from the list to the Commissioner at least once per calendar quarter.

3. A Designation of Agent for Service of Process and Consent to Jurisdiction Form AR-2, published in Section 2303.26(b) of this article, or an alternate form meeting the requirements of Section 2303.22 and approved by the Commissioner, wherein the reinsurer:
 - A. Appoints a licensed California attorney who is a resident of California as its agent for service of process upon whom may be served any notice, summons or process in any action, suit, or proceeding instituted by or on behalf of the ceding insurer; and
 - B. Submits to the jurisdiction of any court of competent jurisdiction in California for the adjudication of any issues arising from the underlying transaction.

(i) To establish continued eligibility of an approved trust, the assuming insurer or group shall file its annual and quarterly financial statements, trust statements and lists of cedants with the Commissioner at the same time such filings are made with the oversight state. Not later than February 28 of each year, the assuming insurer or group shall file the trustees' report required by Code Section 922.4(c)(3)(E). Not later than August 15 of each year, an assuming insurer or group shall file the documents required in subdivision (g) of this section, except that it is not necessary to file duplicates of financial documents already submitted. Alien insurers shall include in the annual filings all reports required by their domiciliary countries.

(j) Pursuant to Section 922.4(c)(5) of the Code, the actual costs and expenses incurred by the Department to review the trusts, subsequent amendments, and periodic filings shall be charged to and collected from the requesting reinsurer or group. The application and filings shall be submitted in the manner set forth in Section 2303.23 of this article.

§2303.6 CREDIT FOR REINSURANCE REQUIRED BY LAW

Credit on financial statements shall be allowed for reinsurance ceded to an assuming insurer not meeting the requirements of Sections 922.4(a), (b) or (c) of the Code, but only as to the insurance of risks located in a jurisdiction where the reinsurance is required by the applicable law or regulation of that jurisdiction, unless the cession is not in compliance with applicable requirements of Sections 2303.11 through 2303.13 of this article. As used in this section, "jurisdiction" means a state, district or territory of the United States.

§2303.7 CREDIT FOR REINSURANCE SECURED BY A SINGLE BENEFICIARY TRUST

(a) Credit on financial statements of a domestic insurer shall be allowed for reinsurance ceded to an assuming insurer to the extent of funds held in a trust satisfactory to the Commissioner for the exclusive benefit of the ceding insurer as security for the payment of obligations under the reinsurance contract, unless the cession is not in compliance with this section and the applicable provisions of Sections 2303.11 through 2303.13 of this article. The amount of the credit shall not exceed the liabilities carried by the ceding insurer.

(b) As used in this subdivision:

1. "Beneficiary" means the entity for whose sole benefit the trust has been

established and any successor of the beneficiary by operation of law. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

2. "Grantor" means the insurer that has established the trust for the sole benefit of the beneficiary.
3. "Trustee" means a qualified United States financial institution as defined in Section 922.7(b) of the Code.

(c) Required provisions of the trust agreement:

1. The trust agreement shall be entered into between the beneficiary, the grantor and a trustee.
2. The trust agreement shall create a trust account into which assets shall be deposited.
3. All assets in the trust account shall be held by the trustee at the trustee's office in the United States.
4. The trust agreement shall provide that:
 - A. The beneficiary shall have the right to withdraw assets from the trust account at any time, without notice to the grantor, subject only to written notice from the beneficiary to the trustee;
 - B. No other statement or document is required to be presented in order to withdraw assets, except that the beneficiary may be required to acknowledge receipt of withdrawn assets; and
 - C. It is not subject to any conditions or qualifications outside of the trust agreement.
5. The trust agreement shall be established for the sole benefit of the beneficiary.
6. The trust agreement shall require the trustee to:
 - A. Receive and hold all assets in a safe place;
 - B. Determine that all assets are in such form that the beneficiary, or the trustee upon direction by the beneficiary, may whenever necessary negotiate any such assets, without consent or signature from the grantor or any other person or entity;
 - C. Furnish to the grantor and the beneficiary a statement of all assets in the trust account upon its inception and at intervals no less frequent than the end of each calendar quarter;
 - D. Notify the grantor and the beneficiary within ten (10) days, of any

deposits to or withdrawals from the trust account;

- E. Upon written demand of the beneficiary, immediately take any and all steps necessary to transfer absolutely and unequivocally all right, title and interest in the assets held in the trust account to the beneficiary and deliver custody of the assets to the beneficiary; and
 - F. Allow no substitutions or withdrawals of assets from the trust account, except on written instructions from the beneficiary, except that the trustee may, without the consent of but with notice to the beneficiary, upon call or maturity of any trust asset, withdraw such asset upon condition that the proceeds are paid into the trust account.
- 7. The trust agreement shall provide that at least thirty (30) days, but not more than forty-five (45) days, prior to termination of the trust account, written notification of termination shall be delivered by the trustee to the beneficiary by registered or certified mail, return receipt requested, or by overnight courier service, signature upon delivery required.
 - 8. The trust agreement shall be made subject to and governed by the laws of California, excepting the conflict of law provisions thereof.
 - 9. The trust agreement shall prohibit invasion of the trust corpus for the purpose of paying compensation to, or reimbursing the expenses of, the trustee.
 - 10. The trust agreement shall provide that the trustee shall be liable for its own negligence, willful misconduct or lack of good faith.
 - 11. The trust agreement shall not contain references to any other agreements or documents except as permitted in paragraphs (c)12, (d)(7) or (d)(8) of this section.
 - 12. Where the trustee is not domiciled in California, the trust agreement shall incorporate by reference and attach as an addendum the form prescribed in Section 2303.22 of this article, wherein the trustee designates an agent for service of process and consents to California adjudication of any issues arising out of the trust agreement.

(d) Permitted provisions of the trust agreement:

- 1. The trust agreement may provide that the trustee may resign upon delivery of a written notice of resignation, effective not less than ninety (90) days after the beneficiary and grantor receive the notice and that the trustee may be removed by the grantor by delivery to the trustee and the beneficiary of a written notice of removal, effective not less than ninety (90) days after the trustee and the beneficiary receive the notice, provided that no such resignation or removal shall be effective until a successor trustee has been duly appointed and approved by the beneficiary and the grantor and all assets in the trust have been duly transferred to the new trustee.
- 2. The grantor may have the full and unqualified right to vote any shares of stock

in the trust account and to receive from time to time payments of any dividends or interest upon any shares of stock or obligations included in the trust account. Any such interest or dividends shall be either forwarded promptly upon receipt to the grantor or deposited in a separate account established in the grantor's name.

3. The trust agreement may provide that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash in United States dollars, certificates of deposit issued by a United States bank and payable in United States dollars, and investments permitted by the Code or any combination of the above; and may further provide that investments in or issued by an entity controlling, controlled by or under common control with either the grantor or the beneficiary of the trust shall not exceed five percent (5%) of total investments.
4. The trustee may be given authority to invest, and accept substitutions of, any funds in the account, provided that no investment or substitution shall be made without prior approval of the beneficiary, unless the trust agreement specifies categories of investments acceptable to the beneficiary and authorizes the trustee to invest funds and to accept substitutions which the trustee determines are at least equal in market value to the assets withdrawn and that are consistent with the restrictions in subdivision (e) of this section.
5. The trust agreement may provide that the beneficiary may at any time designate a party to which all or part of the trust assets are to be transferred. Such transfer may be conditioned upon the trustee receiving, prior to or simultaneously, other specified assets.
6. The trust agreement may provide that, upon termination of the trust account, all assets not previously withdrawn by the beneficiary shall, with written approval by the beneficiary, be delivered over to the grantor.
7. Notwithstanding other provisions of this article, when a trust agreement is established in conjunction with a reinsurance agreement covering risks other than life, annuities and accident and health, where it is customary practice to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:
 - A. To pay or reimburse the ceding insurer for the assuming insurer's share under the specific reinsurance agreement regarding any losses and allocated loss expenses paid by the ceding insurer, but not recovered from the assuming insurer, or for unearned premiums due to the ceding insurer if not otherwise paid by the assuming insurer;
 - B. To make payment to the assuming insurer of any amounts held in the trust account that exceed one hundred and two percent (102%) of the actual amount required to fund the assuming insurer's obligations under the specific reinsurance agreement; or

- C. Where the ceding insurer has received notification of termination of the trust account and where any of the assuming insurer's obligations under the specific reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the obligations and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified United States financial institution as defined in Section 922.7(b) of the Code apart from its general assets, in trust for such uses and purposes specified in subparagraphs (d)(7)(A) and (d)(7)(B) of this section as may remain executory after such withdrawal and for any period after the termination date.
- D. "Obligations" as used in this subdivision means:
 - i. Reinsured losses and allocated loss expenses paid by the ceding company, but not recovered from the assuming insurer;
 - ii. Reserves for reinsured losses reported and outstanding;
 - iii. Reserves for reinsured losses incurred but not reported; and
 - iv. Reserves for reinsured allocated loss adjustment expenses and unearned premiums.
- 8. Notwithstanding other provisions of this article, when a trust agreement is established to meet the requirements of Section 922.5 of the Code in conjunction with a reinsurance agreement covering life, annuities or accident and health risks, where it is customary practice to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:
 - A. To pay or reimburse the ceding insurer for:
 - i. The assuming insurer's share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of the policies, and
 - ii. The assuming insurer's share under the specific reinsurance agreement of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurer, under the terms and provisions of the policies reinsured under the reinsurance agreement.
 - B. To pay to the assuming insurer amounts held in the trust account in excess of the amount necessary to secure the credit or deduction from liability for reinsurance taken by the ceding insurer, or

- C. Where the ceding insurer has received notification of termination of the trust and where any of the assuming insurer's obligations under the specific reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the assuming insurers share of liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer, and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified United States financial institution apart from its general assets, in trust for such uses and purposes specified in subparagraphs (d)(8)(A) and (d)(8)(B) of this section as may remain executory after withdrawal and for any period after the termination date.

(e) The reinsurance agreement secured by the trust permitted under this section shall:

- 1. Provide that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash in United States dollars, certificates of deposit issued by a United States bank and payable in United States dollars, and investments permitted by the California Insurance Code, or any combination of the above;
- 2. Provide that investments in or issued by an entity controlling, controlled by or under common control with either the grantor or the beneficiary of the trust shall not exceed five percent (5%) of total investments;
- 3. Require the reinsurer to execute the Designation of Agent for Service of Process and Consent to Jurisdiction form AR-2 (published in Section 2303.26(b) of this article) and provide it to the ceding insurer upon execution of the reinsurance agreement. In the alternative, the reinsurance agreement may contain provisions whereby the reinsurer:
 - A. Submits to the jurisdiction of any court of competent jurisdiction in California for the adjudication of any issues arising from the agreement;
 - B. Appoints a licensed attorney who is a resident of California as its agent for service of process upon whom may be served any notice, summons or process in any action, suit, or proceeding instituted by or on behalf of the ceding insurer, and provides the California business address of the agent where service may be made during normal business hours; and
 - C. Stipulates that if at any time the reinsurer is without an agent for service of process, or service of process cannot be made upon the appointed agent, service may be made upon the Commissioner, and such service upon the Commissioner shall have the same force and effect as if made upon the reinsurer.

(f) A reinsurance agreement may contain provisions that:

- 1. Require the assuming insurer to enter into a trust agreement to establish a trust account for the benefit of the ceding insurer, and specify what the trust agreement is to cover.

2. Require the assuming insurer, prior to depositing assets with the trustee, to execute assignments or endorsements in blank, or to transfer legal title to the trustee of all shares, obligations or any other assets requiring assignments, in order that the ceding insurer, or the trustee upon the direction of the ceding insurer, may, whenever necessary, negotiate these assets without consent or signature from the assuming insurer or any other entity.
3. Require that all settlements of account between the ceding insurer and the assuming insurer be made in cash or its equivalent.
4. Stipulate that the assuming insurer and the ceding insurer agree that the assets in the trust account, established pursuant to the provisions of the reinsurance agreement, may be withdrawn by the ceding insurer at any time, notwithstanding any other provisions in the reinsurance agreement, and shall be utilized and applied by the ceding insurer or its successors in interest by operation of law, including without limitation any liquidator, rehabilitator, receiver or conservator of such ceding insurer, without diminution because of insolvency on the part of the ceding insurer or the assuming insurer, only for the following purposes:
 - A. To pay or reimburse the ceding insurer for:
 - i. the assuming insurer's share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement because of cancellations of such policies; and
 - ii. the assuming insurer's share of surrenders and benefits or losses paid by the ceding insurer pursuant to the provisions of the policies reinsured under the reinsurance agreement; and
 - iii. any other amounts necessary to secure the credit or deduction from liability for reinsurance taken by the ceding insurer.
 - B. To make payment to the assuming insurer of amounts held in the trust account in excess of the amount necessary to secure the credit or deduction from liability for reinsurance taken by the ceding insurer.
5. Give the assuming insurer the right to seek approval from the ceding insurer to withdraw from the trust account all or any part of the trust assets and transfer those assets to the assuming insurer, provided:
 - A. The assuming insurer shall, at the time of withdrawal, replace the withdrawn assets with other qualified assets having a market value equal to the market value of the assets withdrawn so as to maintain at all times the deposit in the required amount, or
 - B. After withdrawal and transfer, the market value of the trust account is no less than one hundred and two percent (102%) of the required

amount.

The ceding insurer shall not unreasonably or arbitrarily withhold its approval.

6. Provide for the return of any amount withdrawn in excess of the actual amounts required for paragraph (f)(4) of this section, and for interest payments at a rate not in excess of the prime rate of interest on the amounts held pursuant to paragraph (f)(4) of this section.
7. Permit the award by any arbitration panel or court of competent jurisdiction of:
 - A. Interest at a rate different from that provided in paragraph(f)(6) of this section,
 - B. Court or arbitration costs,
 - C. Attorney's fees, and
 - D. Any other reasonable expenses.

(g) A trust agreement in compliance with the provisions of this section may be used to reduce any liability for reinsurance ceded to an unauthorized reinsurer in financial statements required to be filed with this Department, when established on or before the date of filing of the financial statement of the ceding insurer. Further, the reduction for the existence of an acceptable trust account may be up to the current fair market value of acceptable assets available to be withdrawn from the trust account at that time, but such reduction shall be no greater than the specific obligations under the reinsurance agreement that the trust account was established to secure.

(h) The failure of any trust agreement to specifically identify the beneficiary as defined in Section 2303.7(b) of this article shall not be construed to affect any actions or rights which the Commissioner may take or possess pursuant to the provisions of the laws of this state.

§ 2303.8 CREDIT FOR REINSURANCE SECURED BY LETTER OF CREDIT

(a) Credit on financial statements of a domestic insurer shall be allowed for reinsurance ceded to an assuming insurer, in an amount not exceeding the liabilities carried by the ceding insurer, to the extent that security is provided in the form of a letter of credit satisfactory to the Commissioner, unless the cession is not in compliance with the applicable provisions of Sections 2303.11 through 2303.13 of this article.

(b) As used in Section 922.5(b) of the Code and this Section:

1. "Beneficiary" means the entity for whose sole benefit the letter of credit has been established by an issuing or confirming bank and any successor of the beneficiary by operation of law. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).
2. "Applicant" means the reinsurer that applies for and causes the letter of credit to

be issued.

3. "Issuing bank" means a qualified United States financial institution as defined in Section 922.7(a) of the Code which issues a letter of credit.
4. "Confirming bank" means a qualified United States financial institution as defined in Section 922.7(a) of the Code which confirms a letter of credit.

(c) A letter of credit shall not be acceptable to the Commissioner unless it meets the following requirements:

1. The letter of credit shall be issued or confirmed by a qualified United States financial institution as defined in Code Section 922.7(a), which is not affiliated with the applicant or the beneficiary. If the letter of credit is issued by a financial institution authorized to issue letters of credit which does not meet the requirements of Code Section 922.7(a), then the issuing institution shall formally designate a confirming bank as its agent for the receipt and payment of the drafts.
2. The letter of credit shall state that it is clean, irrevocable and unconditional, and shall:
 - A. Contain no reference to any other agreements, documents or entities.
 - B. Provide that, except where the amount of the letter of credit is increased, the letter cannot be revoked or modified without the prior written consent of the beneficiary.
 - C. Provide that the obligation of the issuing or confirming bank is not contingent upon reimbursement or its ability to perfect a lien or obtain a security interest.
3. In order to draw funds, the letter of credit shall require only the presentation of a sight draft indicating the credit number.
4. The letter of credit shall contain an issue date and an expiration date.
5. The letter of credit shall be for a term of not less than one year, unless the ceding insurer has obtained the written consent of the Commissioner for a term of less than one year.
6. The letter of credit shall contain an "evergreen" clause which provides that the term of the letter shall extend automatically without amendment for the same term as the original letter, unless at least sixty (60) days prior to the expiration date, a notice of non-renewal is sent to the beneficiary. The notice of non-renewal shall be sent by registered or certified mail, return receipt requested, or by overnight courier service, signature upon delivery required.
7. Unless the letter of credit is an asset of a trust as permitted in Section 2303.5(f), the letter of credit shall state that it is subject to and governed by the laws of California, excluding the conflict of law provisions thereof.

8. The letter of credit shall state the address of the issuing bank or confirming bank where the letter is issued or confirmed, where it is payable, and where drafts may be presented for payment. The letter may also permit the presentation of sight drafts at other designated offices.
9. If the letter of credit is made subject to the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 500), or any successor publication, then the letter of credit shall specifically provide for a period of not less than sixty (60) days after the resumption of business to draw against the letter of credit in the event that one or more of the occurrences specified in Article 17 of Publication 500, or any successor publication, occur causing interruption of the business of the bank or the beneficiary. The letter shall expressly provide that if there is a conflict between the publication and California law, that California law, excluding the conflict of law provisions, shall control.
10. If the letter of credit is not made subject to the publication referenced in paragraph (c)(9) of this section, the letter shall provide for a period of not less than sixty (60) days after resumption of business to draw against the letter of credit in the event of an interruption of the business of the bank or the beneficiary caused by an Act of God, riot, civil commotion, insurrection, war, terrorism or any other cause beyond control or by any strike or lockout.
11. If the letter of credit is more than one page, each page shall identify the issuing bank and the credit number.
12. The heading of the letter of credit may include a boxed section containing the name of the applicant, the beneficiary's name and state of domicile, and other appropriate notations to provide a reference for the letter of credit. The boxed section shall be clearly marked to indicate that such information is for internal identification purposes only.
13. Unless the letter of credit is an asset of a trust as permitted in Section 2303.5(f), if the address given for the issuing bank, or the confirming bank if one is used, is not in California, then the bank shall provide to the beneficiary a separate writing designating an agent for service of process and consent to California adjudication of any issues arising out of the letter of credit, on a form meeting the requirements of Section 2303.22.

(d) An acceptable form to meet the letter of credit requirements of this section is provided in Section 2306.26(d) of this article. Use of the provided form is optional. To avoid the possible denial of statement credit for reinsurance secured by a letter of credit on a form which varies from the provided form, it is recommended that the alternate form be submitted to the Commissioner for his written determination that the alternate form meets the requirements of this section, in the manner set forth in Section 2303.23 of this article.

(e) Unless the prior written consent of the Commissioner is obtained, a letter of credit may be amended only to modify the amount of the credit, and the amendment must contain the name and address of the issuing or confirming bank and the letter of credit number.

(f) A reinsurance agreement entered in conjunction with a letter of credit shall require the reinsurer to provide a domestic ceding insurer a writing designating an agent for service of process and consent to California adjudication of any issues arising out of the agreement, on a form meeting the requirements of Section 2303.22. In the alternative, the reinsurance agreement may contain provisions whereby the reinsurer:

1. Submits to the jurisdiction of any court of competent jurisdiction in California for the adjudication of any issues arising from the agreement; and
2. Appoints a licensed attorney who is a resident of California as its agent for service of process upon whom may be served any notice, summons or process in any action, suit, or proceeding instituted by or on behalf of the ceding insurer, and provides the California business address of the agent where service may be made during normal business hours; and
3. Stipulates that if at any time the reinsurer is without an agent for service of process, or service of process cannot be made upon the appointed agent, service may be made upon the Commissioner, and such service upon the Commissioner shall have the same force and effect as if made upon the reinsurer

(g) A reinsurance agreement entered in conjunction with a letter of credit may contain provisions that:

1. Require the assuming insurer to provide letters of credit to the ceding insurer and specify what they are to cover.
2. Stipulate that the assuming insurer and ceding insurer agree that the letter of credit provided by the assuming insurer pursuant to the provisions of the reinsurance agreement may be drawn upon at any time, notwithstanding any other provisions in the agreement, and shall be utilized by the ceding insurer or its successors in interest only for one or more of the following reasons:
 - A. To pay or reimburse the ceding insurer for:
 - i. The assuming insurer's share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurers, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of such policies;
 - ii. The assuming insurer's share, under the specific reinsurance agreement, of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurers, under the terms and provisions of the policies reinsured under the reinsurance agreement; and
 - iii. Any other amounts necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer.
 - B. To secure payment of the assuming insurer's obligations where the letter of credit will expire without renewal or be reduced or replaced by a letter

of credit for a reduced amount and where the assuming insurer's obligations under the reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the expiration date, by withdrawing amounts equal to the assuming insurer's share of the liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer and exceed the amount of any reduced or replacement letter of credit, and depositing those amounts in a separate account in the name of the ceding insurer in a qualified United States financial institution apart from its general assets, in trust for such uses and purposes specified in subparagraph (i)(2)(A) of this section as may remain after withdrawal.

3. Provide for an interest payment, at a rate not in excess of the prime rate of interest, on the amounts held pursuant to paragraph (2) above; or the return of any amounts drawn down on the letters of credit in excess of any amounts that are subsequently determined not to be due.

§ 2303.9 CREDIT FOR REINSURANCE SECURED BY FUNDS WITHHELD

(a) Credit on financial statements shall be allowed for reinsurance ceded to an assuming insurer, in an amount not exceeding the liabilities carried by the ceding insurer, to the extent of unencumbered funds withheld by the ceding insurer under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, provided such funds are held in the manner prescribed in Section 922.5(a) of the Code, unless the cession is not in compliance with applicable requirements of Sections 2303.11 through 2303.13 of this article.

(b) Unencumbered funds withheld are those funds that are held solely in the name of and under the exclusive control of the ceding insurer; for example, funds held in an "escrow account" would not meet the requirements of the Code.

§ 2303.10 CREDIT FOR REINSURANCE OF FOREIGN CEDING INSURERS

(a) Foreign ceding insurers shall comply with all reinsurance accounting requirements for the preparation of financial statements for filing in California, except those requirements that are expressly made applicable only to California domestic insurers.

(b) Credit on financial statements for reinsurance ceded to an unauthorized reinsurer may be denied a foreign ceding insurer upon a finding by the Commissioner that either the condition of the reinsurer, or the collateral or other security provided by the reinsurer, does not satisfy the credit for reinsurance requirements applicable to ceding insurers domiciled in California.

(c) When the total credit for reinsurance with a single unauthorized reinsurer exceeds 50% of the ceding insurer's policyholder surplus, the ceding insurer shall file, contemporaneously with the filing of its annual statement:

1. A copy of the reinsurer's annual statements, examination report and independent audit report (meeting the requirements for those reports as set forth in Section 2303.4(b)(5) of this article), where credit is claimed on the basis that the reinsurer is either licensed or accredited as a reinsurer in the ceding insurer's state of domicile; or

2. A copy of the collateral or other security provided by the reinsurer.

(d) A foreign ceding insurer shall provide all information and documentation requested to enable the Commissioner to establish to his satisfaction that the credit for reinsurance standards applicable to ceding insurers domiciled in California have been met. Where credit is claimed on the basis that the reinsurer is licensed in the foreign ceding insurer's state of domicile, the reinsurer must, in substance, meet the licensing standards of California. Where credit is claimed on the basis that the reinsurer is accredited in the ceding insurer's state of domicile, the reinsurer must, in substance, meet the accreditation standards of California. Where credit is claimed on the basis of security in the form of a trust agreement, letter of credit, or funds withheld agreement, the security must, in substance, meet the standards for like security in California.

(e) If the information and documentation submitted by the foreign ceding insurer do not establish to the Commissioner's satisfaction that the requirements of subdivision (d) have been met, credit for the reinsurance shall be denied in the manner prescribed in Section 2303.19 of this article.

(f) The cost of examination of the documents and information submitted to the Department pursuant to the requirements of subdivision (c) and (d) of this section shall be paid by the ceding insurer.

§ 2303.11 TRANSFER OF RISK -- LIFE AND DISABILITY

(a) This section prescribes accounting and other requirements for admitted life and disability insurers and for admitted property and casualty insurers with respect to their disability business. Violation of these requirements results in a ceding insurer improperly reducing liabilities or establishing assets for reinsurance ceded, and, pursuant to Section 922.3 of the Code, the Commissioner shall not allow credit for such reinsurance.

(b) This section shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.

(1) Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt because these do not normally provide significant surplus relief and therefore are outside the scope of this Regulation. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern. Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern.

(2) For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer. For example, for treaties that reinsure policies that are assumed to be issued uniformly throughout the year, the surplus relief could not exceed one-half of one year's valuation mortality cost.

- (3) Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP 61 in the NAIC Accounting Practices and Procedures Manual.
- (c) No insurer subject to this section shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:
- (1) Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured, unless a liability is established for the present value of the shortfall (using assumptions equal to the applicable statutory reserve basis on the business reinsured). Those expenses include commissions, premium taxes and direct expenses including, but not limited to, billing, valuation, claims and maintenance expected by the company at the time the business is reinsured.
 - (A) The primary purpose of the accounting requirements is to prohibit credit for reinsurance under financial arrangements where the ceding company enters into an agreement for the principal purpose of producing significant surplus aid for the ceding insurer on a temporary basis, while not transferring all of the significant risks inherent in the business being reinsured.
 - (B) Subdivision (c), paragraph 1 implements that purpose by prohibiting credit for reinsurance in certain instances where the ceding insurer is afforded a large ceding commission at the inception of the agreement resulting in a significant increase in surplus only to have such surplus increase be drained away in subsequent periods because renewal expense allowances provided under the agreement are insufficient to cover the direct allocable costs estimated at the time the business is reinsured, which are anticipated to be incurred by the ceding insurer in maintaining the business reinsured.
 - (C) An exception to complete disallowance of credit for reinsurance is allowed in situations where the ceding insurer reflects a liability for the present value of the shortage between renewal expense allowances provided under the agreement and the direct allocable costs expected in the future by the insurer in maintaining the business reinsured. This liability must be calculated using actuarial assumptions that are consistent with those utilized in the statutory reserve calculation. The expenses to be accounted for in establishing this liability should represent all costs of the ceding insurer in servicing the business that is subject to the agreement. In determining what the ceding insurer should include in the renewal expenses with regard to direct expenses, there should be an allocation of all renewal expenses anticipated at the time the business is reinsured including salaries, computer usage, postage, etc. This comprehensive calculation should recognize that the anticipated expense levels may be estimated; a comparison with pricing assumptions

may be considered in determining the reasonableness of such assumptions.

- (D) When an agreement does not comply with subdivision (c), paragraph (1) , this area of non-compliance should be addressed by the posting of a reserve for the present value of the deficiency rather than denial for credit for reinsurance, assuming that no other area of non-compliance is encountered with the agreement and that the assets received corresponding to the ceding commission are in compliance with this Regulation and the NAIC Accounting Practices and Procedures Manual. For example, the assets received corresponding to the ceding commission must be admissible and not subject to repayment to the reinsurer.
- (2) The ceding insurer can be deprived of surplus or assets at the reinsurer's option, at a specified time scheduled in the reinsurance agreement, or automatically upon the occurrence of some event, such as the insolvency of the ceding insurer, except that termination of the reinsurance agreement by the reinsurer for nonpayment of reinsurance premiums or other amounts due, such as modified coinsurance reserve adjustments, interest and adjustments on funds withheld, and tax reimbursements, shall not be considered to be such a deprivation of surplus or assets.
- (A) Under a combination coinsurance/modified coinsurance (co/modco) arrangement the ceding company and the reinsurer both establish reserves for future claim payments. Treaty provisions which adjust the reserves each party holds in lieu of transferring funds owed to the reinsurer are acceptable. However, adjustment of reserves in lieu of payment when funds are due to the ceding company is a violation of the accounting requirements since it is a depletion of the ceding company's assets. In other words, statutory gains can be used to increase the modified coinsurance reserve but statutory losses cannot be used to reduce the modified coinsurance reserve. This is the case even if the agreement provides for this adjustment at inception and never requires a payment to be owed by the reinsurer.
 - (B) Under a coinsurance with funds withheld treaty the reinsurer establishes the entire amount of reserve liability on its share of reinsured policies, but the ceding company withholds a portion of the reinsurer's assets typically in an amount less than the reserves, to offset future obligations. Provided the withheld assets are not withheld for any purpose other than the payment of future claims, it is not a violation of the accounting requirements for the reinsurer to require full use of such withheld assets for the payment of claims prior to using any other assets owned by the reinsurer.
 - (C) Subdivision (c), paragraph (2) disallows reinsurance credit if the ceding company can be deprived of assets at the reinsurer's option or automatically upon the occurrence of some event. Thus, a provision in a coinsurance with funds withheld or modified coinsurance treaty which unilaterally or automatically allows the reinsurer to convert the treaty to coinsurance at some later date would be of concern. Although the parties

could have entered a coinsurance agreement at inception, regulators are concerned that the reinsurer would take invested assets from the ceding company at a time which would be to the detriment of the ceding company's policyholders. Therefore, a conversion provision will not violate subdivision (c), paragraph (2) only if all of the following are met:

- (i) the triggers for conversion are limited to ceding company violations of treaty provisions, including complying representations and warranties; the occurrence of a violation has been determined; and the ceding company has been given an opportunity and refuses to promptly remedy the violation;
 - (ii) the conversion is structured so that the surplus of the ceding company will remain unchanged immediately following the conversion;
 - (iii) the invested assets to be transferred upon conversion are less than or equal to the modco reserve, in the case of modco or co/modco, or to the Funds Withheld, in the case of coinsurance funds withheld, and have been maintained in a Trust or Escrow Account since inception of the agreement; and
 - iv) the reinsurance complies with other Credit for Reinsurance requirements in this Regulation immediately upon conversion.
- (3) The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty.
- (4) The ceding insurer must, at specific points in time scheduled in the agreement or at the reinsurer's option, terminate or automatically recapture all or part of the reinsurance ceded.
- (5) The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. For example, it is improper for a ceding company to pay reinsurance premiums, or other fees or charges to a reinsurer which are greater than the direct premiums collected by the ceding company.
- (A) A reinsurer shall not have a unilateral right to establish underlying cost of insurance rates or credited interest rates for policies which are wholly

or partially reinsured. Only the ceding company has the right to set the cost of insurance rates charged policyholders and to set the rates of interest credited to them. However, a representation (but not a warranty) that the ceding company shall vary nonguaranteed elements reinsured in a manner consistent with the ceding company's documented procedures, in effect at the time the agreement was entered into, does not violate the accounting requirements.

- (B) As long as the aggregate amounts payable by the ceding company in any settlement period do not exceed the income of the reinsured policies during that period, a provision in a reinsurance agreement that allows the reinsurer to change the cost of insurance that the ceding company must pay under the agreement would not cause the agreement to be in violation of subdivision (c), paragraph (5). There is not compliance if any changes could cause payments made by the ceding company to exceed income from the reinsured policies, unless the change is necessary to conform to the documented procedures represented to the reinsurer at the time the treaty was entered into and as long as the ceding company has the ability to change the insurance rates it charges policyholders by at least as much as was included in the original representation.
- (C) If a reinsured policy allows the ceding company to guarantee rates of interest to be credited to the policyholder which are greater than those guaranteed by the policy, a provision in a reinsurance contract that allows the reinsurer to limit its participation in the payment of such credited rate would not cause the agreement to be in violation of subdivision (c), paragraph (5), as long as it at least provides for the amount based on the rate guaranteed in the contract and as long as the aggregate amounts payable by the ceding company in any settlement period do not exceed the income of the reinsured policies during that period. There is not compliance if any changes could cause payments made by the ceding company to exceed income from the reinsured policies, unless the limited participation reflects a change in declared interest rates which is necessary to conform to the documented procedures represented to the reinsurer at the time the treaty was entered into and as long as the ceding company has the ability to change the declared interest rates to be credited to policyholders by at least as much as was included in the original representation.
- (6) The treaty does not transfer all of the significant risks inherent in the business being reinsured. The following table identifies for a representative sampling of products or type of business, the risks which are typically considered to be significant Policies enhanced with additional guarantees may contain significant risks not reflected in the table. For products not specifically included, the risks determined to be significant shall be consistent with this table.

TABLE OF SIGNIFICANT RISKS

RISK CATEGORIES:

i. Morbidity

ii. Mortality

iii. Lapse

This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.

iv. Credit Quality

This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rate.

v. Reinvestment

This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

vi. Disintermediation

This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher rates. The company may have to sell assets at a loss to provide for these withdrawals.

+ - Significant 0 - Insignificant
RISK CATEGORY

		i.	ii.	iii.	iv.	v.	vi.
Health Insurance – other than LTC/LTD*		+	0	+	0	0	0
Health Insurance – LTC/LTD *	+	0	+	+	+	0	
Immediate Annuities		0	+	0	+	+	0
Single Premium Deferred Annuities		0	0	+	+	+	+
Flexible Premium Deferred Annuities		0	0	+	+	+	+
Guaranteed Interest Contracts		0	0	0	+	+	+
Other Annuity Deposit Business		0	0	+	+	+	+

Single Premium Whole Life	0	+	+	+	+	+
Traditional Non-Par Permanent	0	+	+	+	+	+
Traditional Non-Par Term	0	+	+	0	0	0
Traditional Par Permanent	0	+	+	+	+	+
Traditional Par Term	0	+	+	0	0	0
Adjustable Premium Permanent	0	+	+	+	+	+
Indeterminate Premium Permanent	0	+	+	+	+	+
Universal Life Flexible Premium	0	+	+	+	+	+
Universal Life Fixed Premium	0	+	+	+	+	+
Universal Life Fixed Premium (dump-in premiums allowed)	0	+	+	+	+	+
*LTC = Long Term Care Insurance						
LTD = Long Term Disability Insurance						

-
- (7) (A) The credit quality, reinvestment, or disintermediation risk is significant for the business reinsured and the ceding company does not (other than for the classes of business excepted in subdivision (c), paragraph [7], subparagraph [B]) either transfer the underlying assets to the reinsurer or legally segregate such assets in a trust or escrow account or otherwise establish a mechanism satisfactory to the Commissioner which legally segregates, by contract or contract provision, the underlying assets.
- (i) Asset segmentation is generally not an acceptable mechanism for legal segregation of assets. Segmentation involves the allocation of a company's general account investment earnings over several lines of business, or various groups of policies within those lines, such that the performance of one corporate bond, for example, may affect the earnings of several segments within a company. The accounting for the segmentation is largely internal, and the detail of the record keeping varies from company to company.
- (ii) The fundamental purpose of the requirement for a reinsurance treaty to employ the use of a segregated asset portfolio ("SAP") is that all payments (interest, benefits, allowances, etc.) must be made from the SAP, so as to eliminate any problems that could arise in determining what asset or assets should be sold, and to avoid disputes in the event of insolvency. Any sale of assets that could affect policies not subject to reinsurance, or policies subject to reinsurance with other reinsurers is problematic. In addition, auditing the performance of a treaty using traditional

segmentation methods would be extremely difficult and prone to disagreement, which could provide a reinsurer with broad leverage to contest amounts due that reinsurer, especially in the event of insolvency or rehabilitation of the ceding company.

- (iii) It is important to determine that the arrangement in place does in fact transfer all of the risks of the underlying assets supporting the reinsured business to the reinsurer.
 - (iv) If some policies out of a group of similar policies are fully or partially reinsured, and the remainder are not, the assets segregated to support the reinsured business shall not be part of an SAP that also includes assets that support policies that are not fully or partially reinsured.
 - (v) If a percentage of all policies in a block of business is reinsured, the ceding company may segregate only assets supporting the reinsured portion or the segregated asset portfolio may represent the entire block of business if the reinsured portion is the same for all policies. In the latter case, the reinsurer would take its proportionate share of the SAP performance.
 - (vi) If the ceding company cedes a portion of each policy in a block of business to one reinsurer and a portion to another under treaties that are virtually identical, it does not need to segregate assets separately for each reinsurer. The assets may be segregated together with each reinsurer responsible for its portion of the investment risk.
 - (vii) The assets should be valued at their statutory admitted value at the time assets are legally segregated under a coinsurance with funds withheld treaty.
 - (viii) When the assets are legally segregated, the funds withheld payables and receivables are reported in the same manner as in a funds withheld treaty where the assets are not legally segregated and will usually mirror the value of the funds withheld account. However, the funds withheld account, which reflects the statutory admitted value of the assets in the SAP, will fluctuate, and thus may differ from the reserves on the reinsured business.
- (B) Notwithstanding the requirements of subdivision (c), paragraph (7), subparagraph (A), the assets supporting the reserves for the following classes of business and any classes of business which do not have a significant credit quality, reinvestment or disintermediation risk may be held by the ceding company without segregation of such assets:
- (i) Health Insurance - LTC/LTD
 - (ii) Traditional Non-Par Permanent
 - (iii) Traditional Par Permanent
 - (iv) Adjustable Premium Permanent
 - (v) Indeterminate Premium Permanent
 - (vi) Universal Life Fixed Premium

(no dump-in premiums allowed)

When assets segregation is not required, the associated formula for determining the reserve interest rate adjustment shall reflect the ceding company's investment earnings and incorporate all realized and unrealized gains and losses reflected in the statutory statement. The following is an acceptable formula:

$$\text{Rate} = \frac{2(I + CG)}{X + Y - I - CG}$$

Where:

I is the net investment income
 CG is capital gains less capital losses
 X is the current year cash and invested assets plus investment income due and accrued less borrowed money
 Y is the same as X but for the prior year

- (8) Settlements are made less frequently than quarterly or amounts receivable from the reinsurer are not paid in cash within ninety (90) days of the settlement date. For example, a modified coinsurance with funds withheld treaty would be in violation of this section since the funds withheld would be structured as a receivable.
 - (9) The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured.
 - (10) The ceding insurer is required to make representations or warranties about future performance of the business being reinsured.
 - (11) The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged.
- (d) Notwithstanding subdivision (c) of this section, the Commissioner may allow such reserve credit or establishment of such asset as the Commissioner considers appropriate. Such allowance shall not be deemed approval of the reinsurance treaty nor shall it be considered an indication that reinsurance credit may be allowed for other similar treaties.
- (e) Any agreement entered into after the effective date of this Regulation which involves the reinsurance of business issued prior to the effective year of the agreement, along with any subsequent amendments thereto, shall be filed by the ceding company with the Commissioner within 30 days from its date of execution if such ceding company is domiciled in this state. In the case of an agreement which was entered into prior to the effective date of this Regulation but was subsequently amended on or after the effective date of this Regulation, such agreement and amendment shall also be filed within 30 days from the date of execution of the amendment if such amendment added business issued prior to the effective year of the amendment and if the ceding company is domiciled in this state.

- (1) Each such filing shall include data detailing the financial impact of the transaction. The ceding insurer's appointed actuary shall consider this section and any applicable actuarial standards of practice when determining the proper credit to take in financial statements filed with this Department. The appointed actuary should maintain adequate documentation and be prepared upon request to justify the inclusion of credit in the financial statement.

- (2) Any increase in surplus net of federal income tax resulting from reinsurance agreements entered into or amended after the effective date of this Regulation which involve the reinsurance of business issued prior to the effective date of the agreements shall be identified separately on the insurer's statutory financial statement as a surplus item and recognition of the surplus increase as income shall be reflected on a net of tax basis as earnings emerge from the business reinsured.
 {For example, on the last day of calendar year N, company XYZ pays a \$20 million initial commission and expense allowance to company ABC for reinsuring an existing block of business. Assuming a 34% tax rate, the net increase in surplus at inception is \$13.2 million (\$20 million - \$6.8 million) which is reported on the "Aggregate write-ins for gains and losses in surplus" line in the Capital and Surplus account. \$6.8 million (34% of \$20 million) is reported as income on the "Commissions and expense allowances on reinsurance ceded" line of the Summary of Operations.

At the end of year N+1 the business has earned \$4 million. ABC has paid \$.5 million in profit and risk charges in arrears for the year and has received a \$1 million experience refund. Company ABC's annual statement would report \$1.65 million (66% of (\$4 million - \$1 million - \$.5 million) up to a maximum of \$13.2 million) on the "Commissions and expense allowance on reinsurance ceded" line of the Summary of Operations, and -\$1.65 million on the "Aggregate write-ins for gains and losses in surplus" line of the Capital and Surplus account. The experience refund would be reported separately as a miscellaneous income item in the Summary of Operations.}

§ 2303.12 TRANSFER OF RISK - PROPERTY & CASUALTY

- (a) A contract for reinsurance must transfer a significant risk of loss to the reinsurer.

- (b) Recoveries due the ceding insurer under a reinsurance agreement must be available without delay. Any provision that may delay timely reimbursement of the ceding insurer violates the conditions for reinsurance accounting and shall be deemed a failure of risk transfer.

- (c) In the review of a reinsurance agreement to evaluate transfer of risk, all contracts between the ceding insurer and related insurers may, in the Commissioner's discretion, be reviewed to determine whether any provision may (a) limit the amount of insurance risk to which the reinsurer is subject under the agreement, or (b) delay the timely reimbursement of claims by the reinsurer.

- (d) Reinsurance agreements that the Commissioner determines fail to transfer risk shall be denied financial statement credit for the cession.

§ 2303.13 CONTRACT REQUIREMENTS FOR STATEMENT CREDIT

(a) No reinsurance agreement or amendment to any agreement may be used to reduce any liability or to establish any asset in any statutory financial statement filed with the Department unless the agreement, amendment, or a binding letter of intent has been duly executed by both parties no later than the “as of date” of the financial statement.

(b) In the case of a letter of intent, a reinsurance agreement or an amendment to a reinsurance agreement must be executed within a reasonable period of time, not exceeding ninety (90) days from the execution date of the letter of intent, in order for credit on financial statements to be granted for the reinsurance ceded.

(c) The reinsurance agreement shall provide, in substance, that:

1. the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement; and
2. any change or modification to the agreement shall be null and void unless made by written amendment to the agreement and signed by both parties.

(d) A reinsurance contract of a domestic ceding insurer shall contain, in substance, the insolvency provision set forth in Section 922.2(a)(2). To meet the “in substance” requirement, the insolvency provision shall expressly include language requiring that, in the event of the insolvency of the ceding insurer and the appointment of a conservator, liquidator or statutory successor:

1. the portion of any risk or obligation assumed by the reinsurer shall be payable by the reinsurer to the conservator, liquidator or statutory successor;
2. payment by the reinsurer shall be made on the basis of claims allowed against the insolvent insurer; and
3. payment by the reinsurer shall be made without diminution because of the insolvency of the ceding insurer, or because the conservator, liquidator or statutory successor has failed to pay all or a portion of any claims.

(e) An insolvency clause that contains only the first sentence of Code Section 922.2(a)(2), verbatim, except that the company names may be substituted for “the ceding company” and “the reinsurer,” is the preferred insolvency clause for domestic insurers. All references to “insolvency” within a reinsurance contract of a domestic ceding insurer shall be contained within the insolvency clause. Statement credit shall not be permitted a domestic ceding insurer for reinsurance agreements which do not contain the preferred insolvency clause, or contain references to insolvency outside the insolvency clause, unless the Commissioner has provided a written determination that the alternate clause or reference meets the requirements of subdivision (d) of this section. A request for a written determination from the Commissioner may be made in the manner set forth in Section 2303.23 of this article.

(f) A setoff or offset clause in the reinsurance contract of a domestic ceding insurer shall not mention "insolvency" nor permit its application in liquidation proceedings.

(g) A reinsurance contract of a foreign ceding insurer shall contain an insolvency clause which, in substance, requires payment by the reinsurer to the conservator, liquidator, rehabilitator or statutory successor, without diminution because of the insolvency of the ceding insurer, or because the conservator, liquidator or statutory successor has failed to pay all or a portion of any claims.

[h] If an arbitration clause is contained in the reinsurance agreement, and the ceding company is a domestic insurer, or a foreign insurer with a significant volume of California business, the following requirements apply:

1. The clause shall include the statement:

"Neither a notice nor demand for arbitration nor a pending arbitration of any matter pertaining to this agreement shall relieve any party of its obligations under this agreement prior to a decision of the arbitrators."

2. The clause shall release a party from its obligation to arbitrate where:

- A. the amount in dispute equals or exceeds 20% of the party's policyholder surplus as reported on its most recent quarterly financial statement; and
- B. from the date of service of notice of appointment of the party's arbitrator,
 - i. the arbitration panel is not selected within 60 days, or
 - ii. the arbitration hearing is not held within 180 days.

3. For a domestic insurer, the clause shall not contain language that may permit the arbitrators to avoid strict compliance with the insolvency clause, such as language that may relieve the arbitrators from strictly following the terms of the agreement or the rules of law.

(i) Agreements which cede business to a licensed or accredited reinsurer shall contain provisions:

- 1. requiring the reinsurer to provide collateral meeting the requirements of Code Section 922.5 within 15 days of a request from the Commissioner to do so, where the request is made on the basis that the reinsurer is the subject of a regulatory order or regulatory oversight by a state in which it is licensed on the grounds of financial hazard, notwithstanding any pending appeal of the order or oversight status; and
- 2. requiring the reinsurer to provide written notice to the Commissioner within five (5) days of receipt of notice in any form or manner that it is the subject of a regulatory order or regulatory oversight, whether such order or oversight is formal, informal, voluntary or confidential, by any state in which it is licensed.

§ 2303.14 PERMITTED CONTRACT PROVISIONS

(a) A reinsurance contract may contain a setoff provision. A setoff provision in the reinsurance contract of a domestic ceding insurer must expressly list the items subject to setoff, which shall be limited to items arising from one or more reinsurance contracts between the same parties, and shall not contain language which "deems" debits and credits to be "mutual."

(b) A reinsurance contract covering property and casualty business may contain an "early termination" provision wherein either party may terminate the agreement upon the occurrence of factors such as changes in the other party's financial ratings or impairment of capital, so long as the basis for termination by the reinsurer does not include the entry of an order of rehabilitation, conservation or liquidation against the ceding insurer. An early termination provision shall require written notice, not less than thirty (30) days prior to the effective date of termination if sent by the ceding company, and not less than ninety (90) days prior to the effective date of termination if sent by the assuming company, with signature upon delivery required.

(c) A reinsurance contract may contain an "extra contractual obligation" provision permitting indemnity of the ceding insurer for damage awards arising from reinsured business, but outside the scope of the underlying policies. Such provisions within the reinsurance contracts of a domestic insurer shall expressly exclude indemnity for loss or liability caused by the ceding insurer's willful acts.

[d] A reinsurance contract with a licensed or accredited reinsurer may contain a provision requiring the reinsurer to establish the collateral prescribed in Code Section 922.5 for conditions which may include (1) the disallowance of credit for the cession by a regulatory authority, (2) a specified reduction in the reinsurer's RBC level, or (3) a specified reduction in the reinsurer's rating by a major rating agency.

[e] A reinsurance contract may contain a choice of law provision for interpretation of the contract. The choice of law provision in the reinsurance contract of a domestic ceding insurer shall specify California law, excluding the conflict of law provisions thereof.

[f] A reinsurance contract may contain a jurisdiction provision. The jurisdiction provision in the reinsurance contract of a domestic ceding insurer shall specify California jurisdiction.

(g) A reinsurance contract may contain an arbitration provision. Where the ceding company is a domestic insurer, the provision shall require the arbitration to be held in California, and shall provide that in the event of the commissioner's appointment as conservator or liquidator of the ceding insurer, the Commissioner may waive the arbitration requirement and enforce the contract in an action before the conservation or liquidation court.

[h] A reinsurance contract may contain a provision permitting the use of a reinsurance intermediary. Where the ceding company is a domestic insurer, or a foreign insurer with a significant volume of California business, payments from one party to the other for obligations arising under the contract shall be made directly between the parties and not through the intermediary. Where payment through an intermediary is permitted pursuant to the provisions of Section 2303.17 of this article, the reinsurance contract shall contain the following language:

"Payments by [the ceding insurer] to the intermediary shall be deemed to constitute payment to (the reinsurer). Payments by (the reinsurer) to the intermediary shall be

deemed to constitute payment to (the ceding insurer] only to the extent that such payments are actually received by (the ceding insurer].”

§ 2303.15 ADDITIONAL REQUIREMENTS

(a) The policyholder surplus of a licensed insurer shall at all times be reasonable in relation to the insurer's total liabilities and adequate to its financial needs, as determined by applying the factors set forth in Code Section 1215.5(f). Reinsurance arrangements that result in a surplus below the required level shall be deemed materially deficient under Code Section 717(d) and grounds for denial of an application for a certificate of authority or amended certificate of authority. For a licensed insurer, the failure to maintain the required level of surplus shall be deemed a violation of Code Section 700(c) and grounds to initiate a license revocation proceeding under Code Section 701.

(b) Cessions or assumptions of 50% or more of an insurer's total liabilities shall not be permitted when ceded under one agreement, without the prior written consent of the Commissioner. Consent for cessions of more than 90% of an insurer's total liabilities on prospective business shall be based only upon demonstrated financial need, for a limited contract period. Applications for the consent required by this subdivision shall be submitted as provided in Section 2303.223, and shall be deemed to satisfy any filing requirement for the transaction under Code Sections 1011.5 or 1215.5(b)(3).

(c) Commitments to the Department made on behalf of an insurer shall be in the form of a certified copy of a board resolution or, at the discretion of the Commissioner, a writing signed by (1) the insurer's chairman, president or any vice president and (2) the insurer's corporate secretary, any assistant secretary, chief financial officer or any assistant treasurer. The Commissioner may request that signatures be notarized. The form of the commitment shall in any event be sufficient to legally bind the insurer.

§ 2303.16 AFFIRMATION OF COMPLIANCE

(a) Licensed insurers shall file with their annual statements an affirmation of compliance with the requirements of Sections 2303.13, 2303.14 and 2303.15(b) of this article. The affirmation shall be verified by an officer and shall be based upon the officer's personal knowledge of the insurer's reinsurance program.

(b) An insurer that is unable to provide one verified affirmation covering its entire program, may provide several verified affirmations, each listing the agreements covered by the affirmation, along with a separate statement verified by an officer that all agreements in the insurer's reinsurance program have been included within the several affirmations. All verifications shall be based upon personal knowledge.

(c) An insurer unable to provide the required verification for an affirmation or separate statement may apply for an exception under the provisions of Section 2303.18 of this article. For good cause shown, the Commissioner may permit verification pursuant to the provisions of Code Section 903.5.

(d) The affirmation and separate statement shall be in a form acceptable to the Commissioner. An acceptable form is published in Section 2303.26 of this article.

§ 2303.17 REINSURANCE INTERMEDIARIES

(a) A licensed domestic insurer, or a foreign insurer with a significant volume of California business, shall not enter a reinsurance agreement that permits or requires the parties to transmit payments due under the agreement to a reinsurance intermediary, unless the Commissioner has examined the intermediary and has issued a determination that payments through the intermediary pose no undue risk to policyholders.

(b) A written request for an examination of an intermediary shall be made by application to the Commissioner. The request shall be made by a licensed insurer and shall include a certified copy of the intermediary's most recent audit report prepared by an independent certified public accountant. An acceptable audit report shall have an "as of" date of not more than fifteen months prior to its submission and shall include a review and report of the intermediary's compliance with applicable Code sections. The Commissioner may request additional documents and records that he deems necessary for the examination. The requesting insurer shall pay the cost of the examination.

(c) After examination of the intermediary and determining that payments transmitted through the intermediary pose no undue risk to policyholders, the Commissioner shall provide written notice to the insurer and the intermediary of his determination. The determination shall be valid for at least one year and shall expire on December 31.

(d) A request for renewal of the determination must be submitted by a licensed insurer on or before July 1 of the year in which the determination expires. Payments may not be transmitted through an intermediary absent a valid determination.

(e) Requests for examination of an intermediary shall be made following the procedures set forth in Section 2303.23 of this article.

§ 2303.18 COMMISSIONER'S DISCRETION

The Commissioner may exercise discretion in requiring strict compliance with the requirements of this article, where the Commissioner determines that (1) the variance is not material, (2) the true financial condition of the insurer may be elicited from analysis of the financial statements and other public documents as may be filed, and (3) compliance would cause undue hardship to the insurer.

§ 2303.19 DENIAL OF STATEMENT CREDIT AND NON-ADMISSION OF ASSETS

(a) Credit on financial statements for reinsurance ceded shall be denied if the applicable requirements of Sections 2303.3 through 2303.13 of this article have not been met.

(b) If any reinsurance recoverable from a reinsurer on paid losses or paid loss adjustment expenses ("LAE") is due more than 90 days, all reinsurance recoverables from that reinsurer on paid losses and paid LAE are deemed non-admitted assets on the grounds of failure in risk transfer. In addition, credits for any other amounts recoverable from that reinsurer (e.g., unearned premiums, unpaid losses, interest and adjustments on funds withheld) may be denied at the discretion of the Commissioner on the grounds of failure in risk transfer.

(c) Upon a determination under this section that credit for reinsurance ceded shall not be permitted or an asset is deemed non-admitted, the Commissioner shall issue a finding in the form of a written explanation to the ceding insurer setting forth the reasons for the determination. The determination may be appealed to the Chief of the Financial Surveillance

Branch, or to the successor position after a reorganization of the Department, in a manner consistent with making a request for a permitted accounting practice.

(d) Denial of credits on financial statements for reinsurance ceded pursuant to subdivisions (a) and (b) of this section shall not be construed to be the only adjustments for reinsurance contemplated under the California Insurance Code. To the extent that the NAIC Accounting Guidance prescribes additional reductions in credits for reinsurance or additional liability provisions for reinsurance, the NAIC Accounting Guidance shall be followed.

§ 2303.20 LICENSE SUSPENSION

Where a reinsurance agreement requires a party to honor the contract obligations during the pendency of arbitration proceedings, or to provide collateral for the business reinsured, or to report regulatory orders or oversight to the Commissioner, the failure to do so shall be deemed (1) a fraudulent business practice, and (2) a failure to honor a contract in good faith, in a license suspension proceeding initiated pursuant to Code Section 704. A party which has not received payment during an arbitration dispute, or has not received required collateral, or becomes aware that the reinsurer has been placed under regulatory order or oversight, shall promptly notify the Commissioner of the possible Section 704 violation by the other party.

§ 2303.21 LICENSE REVOCATION

In a license revocation proceeding initiated pursuant to Code Section 701:

- (a) Any violation of a provision of this article, or of any Code section applicable to a licensed insurer, shall be deemed a failure of governmental control.
- (b) The reinsurance arrangements of an insurer which has ceded 10% or more of its gross written premium under one or more reinsurance agreements that are not in compliance with this article shall be deemed materially deficient under Code Section 717(d), and in violation of the requirements of Code Section 700(c).

§ 2303.22 CONSENT TO JURISDICTION

(a) An acceptable form for the designation of an attorney for service of process and consent to jurisdiction required in this article shall:

- 1. Appoint a licensed California attorney who is a resident of California, as its agent for service of process upon whom may be served any notice, summons or process in any action, suit, or proceeding instituted by or on behalf of the ceding insurer.
- 2. Provide the California business address of the agent where service may be made during normal business hours.
- 3. Stipulate that if at any time the appointing entity is without an agent for service of process, or service of process cannot be made upon the appointed agent, service may be made upon the Insurance Commissioner, and such service upon the Commissioner shall have the same force and effect as if made upon the appointing insurer.
- 4. Stipulate that the appointing entity submits to the jurisdiction of any court of

competent jurisdiction in California for the adjudication of any issues arising from the underlying transaction.

5. The form shall be signed by the president and secretary of the appointing entity and the signatures shall be notarized.
6. The form shall contain an acknowledgement of appointment by the agent, wherein the agent states under penalty of perjury that the agent maintains an office at the address given, and shall be reasonably available during normal business hours for acceptance of service on the appointing company of notices, summons, or other process. The acknowledgment shall state that the agent shall promptly give notice of a change in address to the appointing entity and to the Commissioner. The signature of the agent shall be notarized.

(b) An acceptable form to meet the requirements of this section is published in Section 2303.26(b) of this article. Use of the provided form is optional. A request for a determination that another form meets the requirements of subdivision (a) of this section, may be submitted to the Commissioner in the manner set forth in Section 2303.23.

§ 2303.23 REQUIRED DEPOSITS, LATE FEES AND FILING OFFICES

(a) All costs and expenses incurred by the Department in connection with the review of an application, request or filing made under this article by or on behalf of an insurer in excess of any deposit paid shall be billed to the insurer.

(b) As used in Code Section 924, which assesses late fees for the failure to make timely filings, the term "statements and stipulations" shall include all filings required by this article and the filings required by Code Section 1011.5.

(c) The initial application and annual filings for accredited reinsurers shall be submitted in duplicate, accompanied by a deposit of \$1,500.00.

(d) The initial application and annual filings for an approved trust, and the application for approval of trust amendments, shall be submitted in duplicate. The requesting reinsurer or group shall provide the Department with a \$3,000 deposit in conjunction with the initial application for approval of a trust, a \$1,500 deposit for review of an amendment to the form of an approved trust, and a \$1,500 deposit with the annual filing.

(e) A deposit of \$500 shall accompany requests pursuant to Section 2303.8(d) for a determination that a letter of credit form meets the requirements of Section 2303.8(c).

(f) A deposit of \$500 shall accompany requests pursuant to Sections 2303.13(e) for a written determination regarding the acceptable use of insolvency language.

(g) Applications for the consent required by Section 2303.15(b) of this article regarding specified reinsurance agreements shall be submitted in duplicate, accompanied by a deposit in the amount of \$2,000.

(h) Requests pursuant to Section 2303.17 of this article for the examination of a reinsurance intermediary, or for a renewal of the Commissioner's approval of payments through the intermediary, shall be submitted in duplicate, accompanied by a deposit of \$1,000.

- (i) A deposit of \$500 shall accompany requests pursuant to Section 2303.22 for a determination that an alternate form meets the appointment of agent and consent to jurisdiction requirements of this article.
- (j) The applications, annual filings and requests made pursuant to subdivisions (c) through (h) of this section may be made only by or on behalf of a licensed insurer and shall be submitted to:

California Department of Insurance
Legal Division, Corporate Affairs Bureau
45 Fremont Street, 24th Floor
San Francisco, CA 94105

All other filings or notices required or permitted by this article shall be accompanied by an explanation of the reason for the filing or notice and shall be submitted to:

California Department of Insurance
Financial Analysis Division
300 South Spring Street, South Tower
Los Angeles, CA 90013

§ 2303.24 SEVERABILITY

If any provision of this article, or the application of a provision to any person or circumstance, shall be held invalid, the remainder of the article, and the application of the provisions to persons or circumstances other than those to which it is held invalid, shall not be affected.

§ 2303.25 EFFECTIVE DATE

Section 2303 through Section 2303.26 of this article shall become effective on January 1, 2005, or the 90th day following the day those sections are filed with the Secretary of State, whichever is later.

All reinsurance transactions and any security provided therefore, entered into or renewed after the effective date shall conform to the applicable requirements of Sections 2303 through 2303.26 if credit on financial statements is claimed for reinsurance ceded. All other reinsurance transactions and any security provided therefore shall conform to the applicable requirements of Section 2303 through 2303.26 not later than January 1, 2007, or the 90th day following the day those sections are filed with the Secretary of State, whichever is later, if credit on financial statements is claimed for the reinsurance ceded, unless the Commissioner, in his discretion, provides notice of a later compliance date applicable to such transactions.

Licensees shall follow the requirements of Bulletin 97-5 until the effective date of Sections 2303 through 2303.26; after that date Bulletin 97-5 is void. Licensees shall continue to conform to the requirements of the Accounting Practices and Procedures Manual adopted by the NAIC, to the extent that the Manual requirements do not conflict with the Code or Bulletin 97-5, or, after the effective date of Sections 2303 through 2301.26, with this article.

§ 2303.26 APPROVED FORMS

- (a) The Certificate of Assuming Insurer Form AR-1 as published in this section is required under Section 2303.4 and 2303.5 of this article.
- (b) The Designation of Agent for Service of Process and Consent to Jurisdiction Form AR-2 as published in this section is a form acceptable to the Commissioner under the requirements of Section 2303.23 of this article.
- (c) The Letter of Credit for Reinsurance Form AR-3 as published in this section is a form acceptable to the commissioner for the purpose of securing ceded reinsurance under Section 2303.8 of this article.
- (d) The Affirmation of Compliance Form AR-4 as published in this section is a form acceptable to the Commissioner under the requirements of Section 2303.16 of this article.
- (e) Following are Forms AR-1 through AR-4:

FORM AR-1**CERTIFICATE OF ASSUMING INSURER**

The undersigned insurer, the Assuming Insurer under a reinsurance agreement with one or more insurers domiciled in California, hereby certifies that it:

1. Submits to the authority of the Insurance Commissioner of California to examine its books and records and agrees to bear the expense of any such examination.
2. Submits with this form a current list of insurers domiciled in California reinsured by Assuming Insurer and undertakes to submit additions to or deletions from the list to the Insurance Commissioner at least once per calendar quarter.

Assuming Insurer: _____

NAIC # _____

By (Chairman, President or
any Vice President): _____

Title _____

Date: _____

By (Corporate Secretary, any
Assistant Secretary, Chief
Financial Officer or any
Assistant Treasurer): _____

Title _____

Date: _____

State/County:

On _____ before me, _____, personally appeared _____ and _____, known to me (or proved to me on the basis of satisfactory evidence) to be the persons whose names are subscribed to the within instrument and acknowledged to me that they executed the same in their authorized capacity, and that by their signatures on the instrument the Assuming Insurer, upon behalf of which the persons acted, executed the instrument.

Witness my hand and official seal:

Signature _____ Notary Public

Form AR-1 (09/04)

**DESIGNATION OF AGENT FOR SERVICE OF PROCESS
AND CONSENT TO JURISDICTION**

Know All Persons by These Presents:

That the undersigned, _____, a corporation organized under the laws of _____, hereby appoints and designates _____ (a natural person only), having his/her place of business at _____ in the City of _____, California, _____, as its true and lawful attorney for service of process, upon whom may be served any notice, summons or process in any action, suit, or proceeding instituted by or on behalf of an insurer domiciled in California. If at any time the undersigned is without an agent for service of process, or service cannot be made upon the appointed agent, service may be made upon the Insurance Commissioner of California, and such service upon the Commissioner shall have the same force and effect as if made upon the undersigned. This appointment and designation shall terminate, without notice to the appointee, upon filing with the California Insurance Commissioner a designation form appointing another agent.

That the undersigned hereby consents to the jurisdiction of any court of competent jurisdiction in California for the adjudication of any issues arising from a document where it is a signatory and where an insurer domiciled in California is a cedant or beneficiary. The undersigned agrees to comply with all requirements necessary to give such court jurisdiction, and will abide by the final decision of such court or appellate court in the event of an appeal. However, nothing in this paragraph constitutes a waiver of the right of the undersigned to commence an action in any court of competent jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another court as permitted by the laws of the United States or of any state in the United States. This paragraph is not intended to conflict with or override the obligation of the parties to arbitrate their disputes if such an obligation is created in the underlying document.

Name of Corporation _____

By _____ President

By _____ Secretary

State/County:

On _____ before me, _____, personally appeared _____ and _____, known to me (or proved to me on the basis of satisfactory evidence) to be the persons whose names are subscribed to the within instrument and acknowledged to me that they executed the same in their authorized capacity, and that by their signatures on the instrument the entity, upon behalf of which the persons acted, executed the instrument.

Witness my hand and official seal:

Signature _____ Notary Public

ACKNOWLEDGMENT

I, _____, the appointee named above, do hereby certify that I am the individual named as agent, that I am a licensed California attorney, and that I maintain an office at the address stated for me above. I agree to be reasonably available during normal business hours at such address for service on me for the appointing company of any notice, summons or process. I further agree that in the event the address of my office is changed during the existence of this appointment, I will promptly give notice thereof in writing to the appointing company and to the California Insurance Commissioner.

Signature _____

State/County:

On _____ before me, _____, personally appeared _____ personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same.

Witness my hand and official seal:

Signature _____ Notary Public

Submit original to: California Department of Insurance, Corporate Affairs Bureau
45 Fremont Street, San Francisco, CA 94105
Form AR-2 (09/04)

**LETTER OF CREDIT
AS SECURITY FOR REINSURANCE CEDED**

BANK:
ADDRESS:

For internal identification purposes only.	
Letter of Credit No:	Issue Date:
Beneficiary:	Amount:
Applicant:	Expiration Date:

Letter of Credit No. _____

Issue Date: _____

To Beneficiary: [Name of Insurer Beneficiary]

We have established this clean, irrevocable, and unconditional Letter of Credit in your favor as beneficiary for drawings up to an aggregate of U.S. \$_____, effective immediately. This Letter of Credit is issued, presentable and payable at our office at _____ and expires with our close of business on _____. Except when the amount is increased, this Letter of Credit cannot be modified or revoked without your written consent.

We will promptly honor your sight draft(s) drawn on us, indicating our Credit Number _____, for all or any part of this Letter of Credit, upon presentation at our office at the address given above, or such other office as we may advise, on or before the expiration date hereof or any automatically extended date. Other than your sight draft, no other document need be presented.

This Letter of Credit shall automatically extend without amendment for a period of one year from the expiration date, or any future expiration date, unless at least sixty (60) days prior to any expiration date we notify you by registered or certified mail, return receipt requested, or by overnight delivery service, signature upon delivery required, that this Letter of Credit shall not be renewed.

Our obligation under this Letter of Credit is unconditional and is not dependent upon our ability to perfect a lien, or obtain a security interest or any other form of reimbursement.

The term "beneficiary" as used herein includes any successor by operation of law of the named beneficiary. If a court of law appoints a successor in interest to the named beneficiary, then the term "beneficiary" includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

This Letter of Credit is subject to and governed by the laws of the State of California (excluding the conflict of law provisions), and the Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce, Publication No. 500, or any successor publication, except where that publication is in conflict with California law. Notwithstanding Article 17 of said publication, if this Letter of Credit expires during an interruption of your business or our business, caused by Acts of God, riot, civil commotion, insurrection, war, terrorism, or any other cause beyond control, we hereby specifically agree to pay as provided herein if this Letter of Credit is drawn against within 30 days after the resumption of business.

BANK: _____

AUTHORIZED SIGNATURE: _____

AR-3 (09/04)

FORM AR-4**AFFIRMATION OF COMPLIANCE
(Attach to Annual Statement)**

To: Insurance Commissioner of California
 c/o Chief, Financial Analysis Division
 300 South Spring Street
 Los Angeles, CA 90013

The undersigned officer of _____ (“Insurer”),
 hereby affirms:

1. I have reviewed the requirements of Sections 2303.13, 2303.14 and 2303.15(b) of California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Article 3.

2. The following is a true statement concerning the reinsurance agreements accounted for in the Insurer’s
 _____ (year) Annual Statement (check one):

_____ All of the reinsurance agreements are in compliance with the requirements.

_____ The reinsurance agreements listed on the attachment are in compliance with the above
 referenced requirements. (Attach a descriptive list of the relevant agreements.)

_____ Completed Affirmation of Compliance forms are attached which cover all of Insurer’s
 reinsurance agreements. (Attach Affirmation of Compliance forms.)

3. This affirmation is based upon my personal knowledge.

I declare under penalty of perjury of the laws of California that the above statements are true correct.

Affirmed: _____ (signature of officer)

_____ (printed name)

_____ (title)

_____ (date)

Form Ar-4 (9/04)